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In the Supreme Court of the United States

OCTOBER TERM, 1979

JUNE L. MYERS, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

WADE H. MCCREE, JR.
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The question presented in this income tax case is whether the decision below correctly held that royalties received by petitioner from the transfer of a matured patent application to a controlled corporation were taxable as ordinary income and not capital gains under Section 1239 of the Internal Revenue Code. The resolution of that question, in turn, hinges upon the factual determination whether the patent application was depreciable property (as the patent itself would be). The courts below concluded that the application was sufficiently matured that a patent was virtually certain to issue so that the application was therefore property "of a character which is subject to the allowance for depreciation" within the meaning of Section 1239.

The pertinent facts were stipulated and may be summarized as follows: On December 1, 1958, petitioner's

late husband applied for a patent (Patent Application No. 777,321) covering his invention of a "coupling for conduits." Petitioner's husband died on September 19, 1959, before the patent was issued (R. 337-339).[1] The application was rejected by the examiner, but that rejection was subsequently reversed as to two of the application's three claims by the Board of Patent Appeals on January 2, 1963. In so ruling, the Board declared that it "consider[ed] the patentability of the claims to be already clearly established" (Appellee's Br. 26). On January 31, 1963, the Patent Office issued a formal notice of allowance, which stated that Patent Application No. 77,321 "has been examined and found allowable for issuance of Letters Patent" (R. 253). It also notified petitioner that the "final fee' of $30 thereby became due (*Ibid.*).

Petitioner did not immediately pay the fee for the patent. Instead, acting as administratrix of her husband's estate, she assigned the estate's nine-tenths interest in the patent application[2] to herself in her individual capacity (R. 338). On June 29, 1963, the board of directors of Myers Electric Products, Inc. (Myers Electric), including petitioner, who owned all of the stock of the corporation (R. 339), held a special meeting (R. 259, 260-262). The minutes of that meeting state that it appeared to petitioner's patent counsel "that the patents which had been applied for * * * would finally be granted" (R. 261-262). The Board authorized the corporation's officers to execute a licensing agreement with petitioner (R. 262), and, on the same day, Myers Electric executed such an agreement (Ex. E). The agreement stated that "the parties

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[1]"R." refers to the duplicated record appendix filed in the court of appeals.

[2]Petitioner's husband had assigned the remaining one-tenth interest in the patent to Brodie Ahlport (R. 338).

believe a patent will be issued within the next six calendar months" (Ex. E, at 1), and granted Myers Electric the right to use the invention covered by the patent application for 20 years in exchange for royalties to petitioner. After executing the agreement, Myers Electric paid the final fee to the Patent Office (R. 339), and Letters Patent were issued on September 17, 1963 (R. 254-257, 339).

Initially, for the years 1967 through 1973, petitioner treated the royalties as ordinary income. In 1975, however, she filed a claim for refund, asserting that the royalty income should have been reported as capital gains. This claim was denied by the Commissioner of Internal Revenue (R. 342).

Petitioner thereupon brought this suit for refund in the United States District Court for the Central District of California. The district court held for the government on the ground that the application "was sufficiently matured so as to consider the transfer as having been one of a property which was of a character subject to the allowance for depreciation under 26 U.S.C. section 167" (Pet. App. A-14). It therefore concluded that the royalties were properly taxable as ordinary income under Section 1239 (Pet. App. A-14). The court of appeals affirmed (Pet. App. A-1 to A-7).

1. The decision below correctly held that the royalties at issue were taxable as ordinary income under Section 1239. Petitioner principally argues (Pet. 5-7) that the decision conflicts with *Lan Jen Chu* v. *Commissioner*, 486 F. 2d 696 (1st Cir. 1973). That case, however, is factually distinguishable. In *Lan Jen Chu*, the taxpayer had not received a notice of allowance prior to transfer of the patent application to the controlled corporation. Thus, at that

time, it was not at all certain that the patent application would be approved (see 486 F. 2d at 702). On the other hand, here and in *Estate* of *Stahl* v. *Commissioner*, 442 F. 2d 324 (7th Cir. 1971), which the decision below cited with approval, the patent applications had been approved prior to their transfer. Thus, the decision below does not conflict with *Lan Jen Chu*.

To be sure, the court in *Lan Jen Chu* acknowledged (486 F. 2d at 703, n.8) that a patent in some cases may not be issued after a notice of allowance due to certain unusual circumstances, such as fraud. But there is no such evidence in this case. To the contrary, the record overwhelmingly supports the conclusion of the courts below that the issuance of the patent here was a virtual certainty at the time petitioner transferred it to Myers Electric.

2. Petitioner alternatively argues (Pet. 7-8) that the decision below is contrary to the language of Section 1239 of the Code and that the court of appeals erred in looking to the legislative intent to close what it perceived to be a tax "loophole" (Pet. 7).

But the decision below is squarely supported by the terms of the statute. Section 1239 provides that any gain on the sale or exchange, "directly or indirectly," of depreciable property between a transferor and a corporation controlled by the transferor is treated as ordinary income instead of capital gain. A patent application that has been approved by the Patent Office through the issuance of a notice of allowance is a depreciable asset. *Associated Patentees, Inc.* v. *Commissioner*, 4 T.C. 979 (1945), acq., 1959-2 Cum. Bull. 3; *Best Lock Corporation* v. *Commissioner*, 31 T.C. 1217 (1959); *Century Tank Manufacturing Co.* v. *Commissioner*, 28 T.C.M. para. 59,095 (1959); *McDermott* v. *Commissioner*, 41 T.C. 50 (1963); Rev. Rul. 67-136, 1967-1 Cum. Bull. 58.

Petitioner nevertheless asserts (Pet. 8) that a patent application lacks all the essential attributes of depreciability, that is, an ascertainable useful life and a salvage value. Rev. Rul. 67-136, *supra*, however, allows a patent purchaser to deduct the annual royalty payments made to the patent seller as a depreciation expense. The patent application involved here is plainly within the purview of Rev. Rul. 67-136. The issuance of the patent was a virtual certainty at the time of transfer because a formal notice of allowance had been issued. Furthermore, the licensing agreement between petitioner and Myers Electric provided for annual royalty payments for a period of 20 years. Since petitioner conveyed, directly or indirectly, a depreciable asset to her controlled corporation, the decision is fully in accord with the plain language of Section 1239.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.
Solicitor General

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